

Internal Revenue Service
Memorandum

CC:INTL-0320-89

Brl:WEWilliams

Date: JUL 10 1989

to: District Counsel, Manhattan
Attn: Peter Graziano

from: Chief, Branch No. 1
Associate Chief Counsel (International) CC:INTL:1

subject: I.R.C. §§ 897 and 1445
Foreign Investment in U.S. Real Property and
Withholding Requirements of the Transferee

This refers to your memorandum dated April 20, 1989, in which you request advice on a question pursuant to Tax Litigation Manual § (35)(8)(12)(6), dealing with oral technical advice. Because the issue that you request advice on is of some importance, we are treating it as a request for informal technical advice and responding in writing.

The major issues on which you request advice are as follows:

1. Whether the withholding obligation imposed by I.R.C. § 1445(a) on the transferee of a U.S. real property interest from a foreign person is an income tax for which a statutory notice of deficiency is required.
2. Whether the withholding obligation imposed under section 1445(d)(2) on an agent of the buyer or seller of a U.S. real property interest who knows that a non-U.S. real property interest statement or non-foreign status statement is false, and who does not provide written notice of such knowledge to the buyer, pursuant to section 1.1445-4(a) and (c) of the Treasury Regulations, is an income tax for which a statutory notice of deficiency is required.

As we understand the facts, the Manhattan District Director's office has used public sources of information and identified 65 transactions which involve the sale of U.S. real property interests by foreign persons to U.S. citizens or corporations during the years 1985 through 1988. With respect to these transactions, the District Director has ascertained that no resident tax returns have been filed with the Brookhaven Service Center for the foreign entities involved; no non-resident tax returns have been filed with the Philadelphia Service Center for the foreign entities; and no Forms 8288, U.S. Withholding Return for Dispositions by Foreign Persons of U.S. Real Property Interest, have been filed by the transferees.

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The District Director anticipates contacting the transferees to obtain further information regarding the transactions, and the potential liabilities of the transferees and/or agents of the purchasers and sellers of the U.S. real property interests. The District Director has drafted a letter to be sent to a transferee advising him that the IRS has no record of the filing of a Form 8288 and requesting a copy of the return if one was filed. If a Form 8288 was not filed, the proposed letter asks the transferee to contact a person in the Director's office. If the Director receives no response to the letter, a second letter will be sent to the buyer and a letter to the buyer's agent. If no response is received to these letters, a deficiency of 10 percent of the amount realized by the seller will be determined against both the transferee and the transferee's agent.

It is your view that the amounts that the District Director determines should have been withheld by the transferee or the transferee's agent, but were not withheld, are deficiencies within the meaning of section 6211 and that, therefore, statutory notices of deficiency must be sent to the transferee and/or to the agent. For the reasons stated below, we agree that statutory notices should be issued under these circumstances.

Generally, under I.R.C. § 897(a), a nonresident alien individual or a foreign corporation's gain or loss from the disposition of a U.S. real property interest, defined in section 897(c), is taxed "as if the taxpayer were engaged in a trade or business within the U.S. during the taxable year and as if such gain or loss were effectively connected with such trade or business." This section applies to dispositions made after June 18, 1980.

Section 897 was originally enacted by the Omnibus Reconciliation Act of 1980, P.L. 96-499 (Dec. 5, 1980), 1980-2 C.B. 509. In connection with its consideration of the proposed Bill, which as passed by the House had no withholding provision, the Senate added an amendment requiring withholding under circumstances similar to the ones in the current statute. However, the Conference Committee rejected the Senate amendment in the view that it was better to enact the Bill as proposed by the House and to give more consideration to withholding provisions

to ensure that they would not inadvertently disrupt the U.S. real estate market or expose U.S. buyers or U.S. agents of foreign sellers of U.S. real estate to liability where such liability would not be appropriate. Given this potential, the House conferees took the position that withholding provisions should not be

adopted until they could be more fully considered by the committees and the public had adequate opportunity to consider and comment on the proposed withholding mechanism.

H.R. No. 96-1479, 96th Cong., 2d Sess. 189-190 (Nov. 26, 1980), 1980-2 C.B. 575, 586.

Section 1445(a), enacted by section 129 of the Tax Reform Act of 1984, P.L. 98-369 (Oct. 31, 1984), originated as a Senate amendment to the House Bill and

generally imposes a withholding obligation when a U.S. real property interest is acquired from a foreign person. Withholding is required unless one of five exemptions applies. The withholding obligation is generally imposed on the transferee. In certain limited circumstances, an agent of the transferor or transferee is required to withhold.

General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984, prepared by the Staff of the Joint Committee On Taxation (Dec. 31, 1984). The amount required to be withheld is 10 percent of the amount realized on the disposition of the U.S. real property interest up to the amount of the transferor's maximum tax liability. I.R.C. § 897(c)(1)(B). There are five exemptions from the withholding requirement and include the case of a transferor's furnishing an affidavit to the transferee that the former is not a foreign person (I.R.C. § 1445(b)(2); or a statement that the transferor has reached agreement with the Secretary concerning payment of any tax under section 871(b)(1) or 882(a)(1) on any gain to be recognized by the transferor; or a statement that the transferor is exempt from tax imposed by section 871(b)(1) or 882(a)(1) on any gain to be recognized on the disposition (I.R.C. § 1445(b)(4)(B)).

Furthermore, under section 1445(d), an agent of a transferor or transferee may be liable for the withholding required by section 1445(a) up to the amount of compensation that the agent derives from the transaction. Generally, an agent may be held liable, "for the tax that the recipient of the notice would have been required to withhold under section 1445 if such notice had been given" (Treas. Reg. § 1.1445-4(e)) where he has actual knowledge that an affidavit furnished by a transferor to a transferee is false and does not notify the transferee of this fact. I.R.C. § 1445(d)(1) and (2). See Treas. Reg. § 1.1445-4 generally for the notice requirements of agents.

Section 1.1445-1(c)(1) of the Treasury Regulations is, in part, as follows:

A transferee must report and pay over any tax withheld by the 20th day after the date of the transfer. Forms 8288 and 8288-A are used for this purpose, and must be filed with the Internal Revenue Service Center, Philadelphia, PA Pursuant to section 7502 and regulations thereunder, the timely mailing of Forms 8288 and 8288-A will be treated as their timely filing.

Section 1.1445-1(e)(1) of the Regulations states as follows:

Every person required to deduct and withhold tax under section 1445 is made liable for that tax by section 1461. Therefore, a person that is required to deduct and withhold tax but fails to do so may be held liable for the payment of the tax and any applicable penalties and interest.

Section 1.1445-1(e)(2) of the Regulations provides in part that

if a transferee is required to deduct and withhold tax under section 1445 but fails to do so, then the tax shall be assessed against and collected from that transferee. Such person may also be subject to any of the civil and criminal penalties that apply. Corporate officers or other responsible persons may be subject to a civil penalty under section 6672 equal to the amount that should have been withheld and paid over.

As explained in section 1.1445-1(e)(1) of the Regulations, supra, a transferee's liability for tax that he should have withheld, but did not, is based on section 1461. Section 1461 is as follows:

Every person required to deduct and withhold any tax under this chapter is hereby made liable for such tax and is hereby indemnified against the claims and demands of any person for the amount of any payments made in accordance with the provisions of this chapter.

There are no Regulations under section 1461 dealing specifically with a person's withholding liability under section 1445.

Section 6211(a) defines "deficiency" as certain underpayments "of income, estate, and gift taxes imposed by subtitles A and B" Both sections 1445 and 1461 are in subtitle A. Section 6212(a) authorizes the Secretary, if he "determines that there is a deficiency in respect of any tax imposed by subtitle A or B ..." (emphasis added), to send a statutory notice of deficiency.

It is our view that the same rules apply with respect to withholding required by section 1445 as apply with respect to income tax withholding under section 1441. While S-K Liquidating Co. v. Commissioner, 64 T.C. 713 (1975), did not involve the issue of whether the IRS must send a statutory notice when there has been a failure to withhold under section 1441, the IRS did issue a statutory notice to the withholding agent in that case.^{1/} The court, at pages 717-718, stated the following with respect to a withholding agent's tax liability under section 1441:

We recognize that as a withholding agent, petitioner is a "taxpayer" for purposes of a petition to the Tax Court contesting its liability for withheld taxes.
[Citations omitted.]

* * *

Thus, although the liability of the petitioner for taxes as a withholding agent appears to fall within the literal language of section 6212(c) in that as withholding agent petitioner is the taxpayer entitled to file a petition in the Tax Court, is personally liable for the tax, and the tax is an "income tax" in that it is imposed under chapter 3 (Withholding of Tax on Nonresident Aliens, etc.) of subtitle A (Income Tax),
....

One of the cases cited by the Tax Court in S-K Liquidating Corp. for the proposition that a person responsible for withholding under section 1441 is a "taxpayer" for purposes of filing a petition with the Tax Court is Houston Street Corp. v. Commissioner, 84 F.2d 821 (5th Cir. 1936).

In Houston Street Corp., the petitioner failed to withhold taxes on compensation paid to two nonresident aliens, as required by section 221(a) of the Revenue Act of 1926, the predecessor of section 1441 of the 1986 Code. Relying on section 221(c) of the 1926 Act, the predecessor of section 1461 of the 1986 Code, the IRS made a jeopardy assessment and sent a statutory notice to the petitioner. A petition was filed with the Board of Tax Appeals which, in an unreported memorandum opinion, held that the petitioner was a withholding agent and not a taxpayer.

^{1/} The issue was whether the IRS may issue a second statutory notice determining a deficiency in the withholding agent's own income tax liability. The IRS adopted the Tax Court's position in S-K Liquidating Co., in Rev. Rul. 75-552, 1976-2 C.B. 476.

Relying on the definition of "taxpayer" in section 2 of the 1926 Act, essentially the same definition as currently contained in section 7701(a)(14) of the 1986 Code, as "any person subject to a tax imposed by this act [title]", the Fifth Circuit concluded that a withholding agent under section 221(a) of the 1926 Act (section 1441) is "made liable for the tax imposed upon the nonresident aliens" by section 221(c) of the 1926 Act (section 1461). Therefore, the Fifth Circuit determined that the Board of Tax Appeals had jurisdiction over the petition and reversed and remanded the case.

The distinction between assessment of a 100-percent penalty against a responsible officer, for which a prior statutory notice is not required, and assessment of tax against a withholding agent under section 1441, for which a prior statutory notice is required, is pointed out in Enochs v. Green, 270 F.2d 558 (5th Cir. 1959). In that case, the IRS assessed a 100-percent penalty against an officer of a defunct corporation to collect unpaid FICA and withheld income taxes. The officer sued for an injunction contending that the assessment was invalid, because no statutory notice of deficiency had been issued. The district court issued a temporary injunction, and the district director appealed.

The Fifth Circuit noted that employment taxes, for the collection of which the 100-percent penalty assessment was made, are not included within the taxes for which the Commissioner is authorized to send a statutory notice under the predecessor of section 6212(a) and that these taxes are in respect of the wages of employees and not taxes on employers. The court also referred to the predecessor of section 7501(a), that provides as follows:

Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States. The amount of such fund shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such fund arose. [Emphasis added.]

Observing, at page 561, that the 100-percent penalty assessment "did not arise from a tax where notice was required before distraint", the court held that a statutory notice is not a prerequisite to a 100-percent penalty assessment. The court contrasted this situation to certain withheld income taxes as follows:

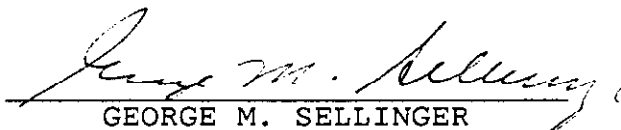
If this were a case where a penalty had been imposed for the non-payment of a tax withheld on tax-free covenant

bonds, or on the income of a non-resident alien, or on the income of a foreign corporation pursuant to the Chapter 1 provisions of Section 143 or Section 144, 26 U.S.C.A. (I.R.C. 1939) §§ 143, 144^[2], it seems that distraint for the collection of such penalty could be enjoined unless a deficiency notice had been given. [Citations omitted.]

We recognize that our view that a statutory notice of deficiency must be issued in a case involving failure to withhold under section 1445 may be interpreted as inconsistent with O.M. 20124, [REDACTED] (Feb. 4, 1988). However, the issue in the O.M. was not whether a statutory notice must be issued to a withholding agent with regard to a failure to withhold under section 1441. Rather, the issue was whether the IRS may rely on section 6501(e)(1)(A) in making an assessment for the failure to withhold under section 1441. The O.M. concludes that the withholding agent's liability under sections 1441 and 1461 is not an income tax and, therefore, that the 6-year statute of limitations does not apply. The O.M.'s holding that the liability under sections 1441 and 1461 is not an income tax liability seems contrary to the Tax Court's opinion in S-K Liquidating Co. and to the Fifth Circuit's opinion in Houston Street Corp.

It is our view that if there is not clear authority that a statutory notice must be issued with respect to a failure to withhold under section 1441 (and, by analogy, under section 1445), there is at least some precedent in this regard. You state in your memorandum that the statute of limitations is not running. Under these circumstances, we think that the most conservative course of action will be to issue a statutory notice for a failure to withhold under section 1445(a) or for failure of an agent of the transferor or transferee to furnish the notice to the transferee required by section 1445(d)(1). If a petition is filed in the Tax Court and the Tax Court decides that it does not have jurisdiction over these cases, an assessment can then be made.

If you have any questions, please call Ed Williams at FTS 287-4851.


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² / Sections 1441 and 1442 of the 1986 Code.